RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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July 26, 2000 **LETTER 1304**

July 7, DJIA 10635.98; PTI 5136; A-D Ratio -5.89
July 14, DJIA 10806.74; PTI 5156; A-D Ratio -5.41
July 21, DJIA 10733.56; PTI 5155 ; A-D Ratio - 5.82
Dow Yield: 1.57%; Dow Price/Earnings: 20.8
Dow Times Book Value: 6.55%
Percentage of Undervalued Blue-chips: 15%
Gold 34-day MA: 284

THE PICTURE: Late July: Personally, I'm largely in what I consider the safest and best values in the markets and that's in muni bonds (although I do own some Utility stocks). One advantage of this position is that I have no vested interest in which way this dividend-less stock market goes. If, for instance, the Dow climbs to 14,000 that's fine with me. Conversely, if the Dow drops through 8,000 I won't lose any sleep -- of course, I'd be sorry to see it happen for the sake of America's millions of stockholders.

What I'm saying is that I don't have an axe to grind, regardless of what the market does. I think I can take an unbiased view of the market.

One **huge plus** for this market is as follows: For eighteen years or ever since 1982, the Dow has refused to break below the low close of a preceding year. This incredible performance is **still intact.** The low for the year 1999 was 9120.67. Unless the Dow closes below 9120.67 this year, the long bullish series will remain INTACT. To my mind, this is probably the best argument by those who say that the major trend of this market is still UP.

On the bearish side we have two main items: we have extreme overvaluation and negligible dividends -- and we have my "top-out parade," a parade which I won't include again here. The top-out parade consists of a long list of stock averages and indices, all of which have recorded important highs. And I believe they are bull market highs. If these highs remain intact, then the bull market is over. So far, none of these highs have been bettered. But as of today, the Utility Average is close.

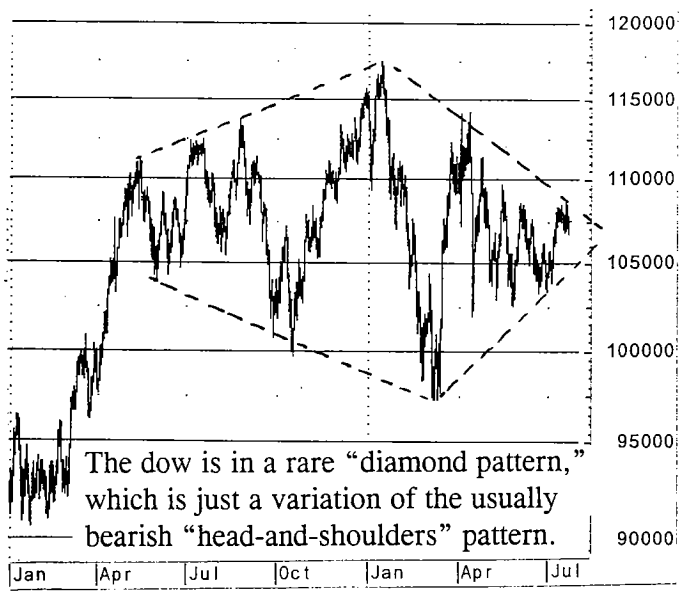
In view of the above, what do we have? We have an extremely high-priced, over-valued market that has not yet "fallen apart." We have a market that might be thought of as locked into "no-man's land." It's a market that has not yet rallied to new highs, and a market that refuses to collapse in a major way.

On my web site, I include a piece entitled "Rich man, poor man." In it I write that the wealthy investor is never in a hurry. His priorities are safety first, then income and finally capital gains. The wealthy investor doesn't need the markets because he has money coming in at all times. The wealthy investor puts his money where he thinks the best values lie. At any given time, he may be buying classic paintings, jewelry, bonds, stocks, real estate, or if he can find no bargains at all, he may park his money in US T-bills (where at least he is enjoying a partially tax-free income).

This may be the reason why the bonds have been strong of late, and particularly the municipal (tax-free) bonds. For many investors, buying bonds that provide tax-free income of 5.6% as against buying high-priced stocks that pay no dividends is a "no-brainer." Today the "big money" investor (who is concerned mainly with safety and income) may opt for bonds over stocks, and in many cases he'll opt for muni bonds.

Obviously, that doesn't mean that stocks can't go higher. It simply means that stocks at this point are not where many wealthy individuals want to put their money.

Remember, the public is not a great judge of **values.** But the wealthy investor does tend to be a good judge of values. If the public was a good judge of values, they'd all be rich. And they're not. The "little guy" tends to run with the crowd; the wealthy investor tends to move against the crowd and towards VALUES.



The dow is in a rare "diamond pattern," which is just a variation of the usually bearish "head-and-shoulders" pattern.

One phenomenon of today is the tremendous number of hype machines that are in place. Wherever you go, the advantage of stocks is espoused. I often use the number of stock market books on the shelves of major book stores as a gauge of the public's interest in the stock market.

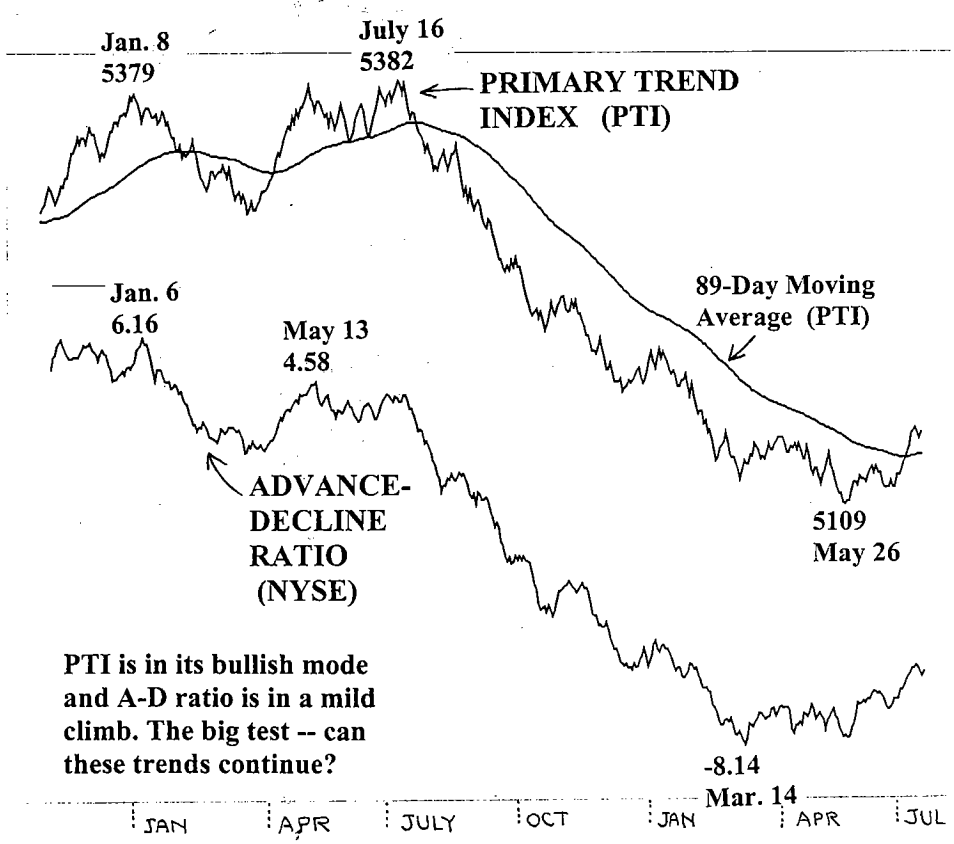
Go into any large book store today and check out the book shelves devoted to the stock market. There are a large quantity of books available. The conclusion is clear -- the public is buying stock market books by the bushel. I just heard that a new TV series is slated for the Fall. It will be called, "The Street."

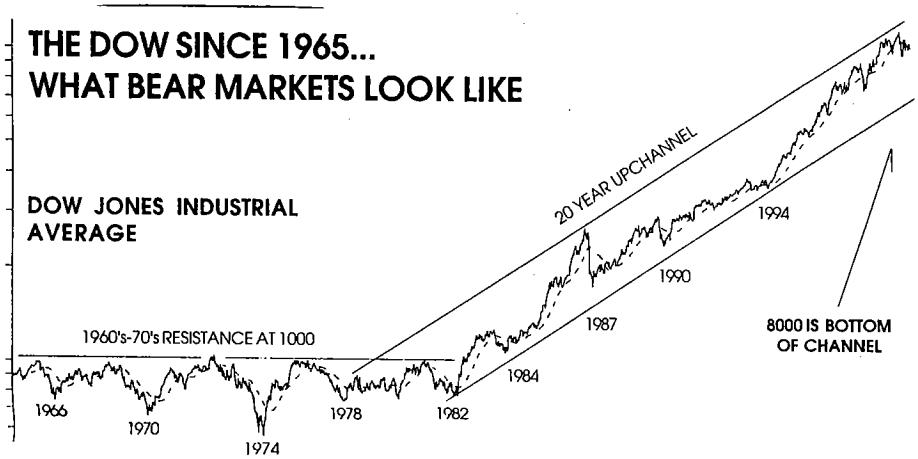
The stock market today is a modern phenomenon. The stock market is as loved today as it was hated or ignored when I first started watching the market back in the mid-1940s. Today, in my opinion, the stock market is a mania, it's a raging fever.

Item: Listening to CNBC I have to wonder what the devil these people would talk about all day if they couldn't talk about the ridiculous quarterly earnings reports ("up a penny, down a penny"). Was it CNBC that started this quarterly nonsense?

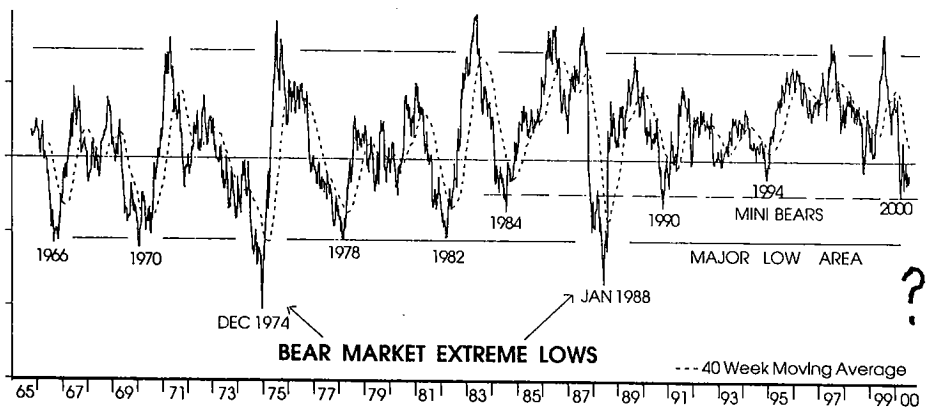
Where Are We? The chart on the right was published by my old friends, the two Aden sisters (1-888 233-6658). These two lovely ladies put out one of the best and most useful reports in the business. This chart shows the whole picture from 1966 to the present.

Note how the Dow peaked in '66 and sank in a mini-bear market to the '66 low. Then the Dow rallied to a high in '68, only to undergo another mini-bear market that bottomed in 1970. Next we saw another mini-bull market to a high





LEADING INDICATOR (LONG-TERM):
Holding at 1990 lows, but will it fall to bear market major lows?



in 1972, and from there the severe bear market finale down to the 1974 low.

At the **bottom section of the chart** we see a 40-week moving average of the Dow. This identifies the major bear market bottom of December, 1974. From there we had a series of advances interspersed with corrections, and then an important second major bottom in January, 1988.

From 1988 the Dow turned up, and it continued up on a trend basis to January 2000. This year the 40-week moving average declined to the mini-bear level seen on the lower part of the chart. This is the same approximate level that we saw in 1990 and 1994. But it was not a major oversold bear market level of the type seen in 1974 and again in 1988.

As the chart shows, it's been 12 years since we've seen a major bear market low. Are these major, sold-out bear market lows extinct? I wouldn't bet on it.

Conclusion: Unless or until we get a major oversold bottom, I'll continue to advise extreme caution in our investments. Extreme caution calls for T-bills, T-notes, muni bonds, and conservatism. Our job in the current market environment is to **avoid the BIG LOSS.** With my own assets, I'm doing that by opting for debt instruments over equities.

Item: On May 16, just two months ago, the Fed raised the discount rate to 6%. This was the seventh time the discount rate has been raised to 6% since 1920.

I went back and checked what happened in the previous six instances. The first boost occurred on January 23, 1920. The market turned down in March and continued down into October.

The second boost to 6% occurred on August 9, 1929. A month later the market hit its high, and I don't have to tell you what happened after that.

The third boost occurred on April 3, 1969. The market topped out in early May and collapsed to a low in December.

The fourth boost occurred on April 11, 1973. The market was already on its way down, and by late 1974 the Dow had lost half its value.

The fifth boost came on October 26, 1977. The market had been declining all year (gold and oil surging, rates rising). The decline did not end until March of '78.

The sixth boost occurred on September 4, 1987. This was followed by the "crash of '87," which many of my subscribers remember only too well.

Conclusion: When the discount rate rises to 6%, you're spinning your wheels trying to make money in the stock market.

Comment: The current stock market acts, in my opinion, very much like the commodity market. By that I mean that in commodities you do maybe ten trades and on six of them you make a little. On three you break even. Then on the tenth trade you get hit with a "limit down" and you end up losing money on the whole effort. That limit down killed you.

Today in the stock market you buy ten "good" stocks. Five go up a bit, two sit, and two drift off. But the tenth falls out of bed -- it drops 35% overnight. And in the end, you're sitting with a loss and you're discouraged. That, I think, is typical of what's been happening in this market.

I think the trend of margin accounts on the NYSE will tell an interesting story from here. As the bear market moves on, an increasing number of speculators will get "beaten." They will accumulate losses, and in time they will quit the market. As they quit, they will close out their margin accounts. This will show on the trend of total margins on the Big Board. Margin totals, by the way, are now well off their March record high of $278.5 billion.

INVESTMENT POSITION: The **bear** remains in the box. And now I want to say something about dividends and investing. History shows that over any considerable length of time, dividends account for roughly **half the gains** in stocks.

At this time, **long-term holders** of stocks have two phenomena working **against** them. **(1)** When S&P price/earning ratios are as high as 22, over the next ten years stockholders can expect to see appreciation in their portfolios of around 5% a year. But there's a further problem -- the P/E ratio for the S&P is not just 22, today it's **over 29.**

(2) The above 5% appreciation statistics were based on average dividend yields of around 4%. But the dividend yield on today's over-priced S&P is now only **1.07%**. So over the next ten years I doubt if the appreciation in stocks will even be as high as 5% a year (remember, half the return on stocks over the years has come from dividends).

I want to explain a concept that I wrote on a recent web site report. Once you take a position in stocks, you want those stocks to rise. That is, unless you are willing to "average down" in a declining stock market, a procedure that I do NOT advise.

But if you have a policy of buying bonds, once you take your initial position you want bonds to go down. The reason, of course, is that when bonds go down their yields rise. So if you have a policy of buying bonds on a regular basis, you are much better off accumulating bonds with higher yields. Your bonds will all mature at par (1000) so that even if your bond declines after you buy it, it will climb back, and in time your bond will mature at 1000.

NOTES & QUOTES: Greenspan is taking the big gamble. The big gamble is that in the face of obvious roaring inflation, he's finished raising rates, at least until AFTER the November elections.

What's he thinking? Here's what he's thinking, in my opinion: (1) Gold has not moved. (2) Bonds are near their highs, and the Fed has only moved when the bonds force them to move -- in other words when the bonds headed down and rates moved higher, the Fed followed by raising rates. (3) The dollar has been strong, and a strong dollar is anti-inflationary. (4) Finally, for political reasons Greenspan would love to get by the election without having to raise rates. And that looks like just what he's going to do.

* *

Earnings for a corporation are whatever an accountant says they are. But dividends, corporations paying out cold, hard cash, is another matter. Corporations don't lightly raise dividends and once a dividend rate is established, corporations hate to lower the dividend, since lowering a dividend is an open, public admission that something is wrong.

Instead of paying dividends, the trend today is to "bull" your stock higher. One popular way of doing this is to borrow money (usually issuing bonds) and at the same time buy back your stock. Thus, by shrinking the equity base and increasing the debt base, more of a corporation's earnings are shifted into the equity side of the equation even while the debt side expands.

This hardly improves a corporation's books, but it does serve to show rising earnings for the stock, and with today's huge emphasis on moving one's stock up, this is the popular maneuver of the day.

One of the best gauges of "how corporations are doing" is the trend of dividend increases. A corporation does not raise its dividend payout without a lot of thought. And corporations do not raise dividends unless they are reasonably certain that they can maintain the higher dividend.

Along these lines, I thought this report from S&P was worth thinking about. S&P reported that the number of corporations raising dividend payments for June fell to 86. This compares with 113 dividend boosts in June, 1999 and 154 dividend boosts in June, 1998. So the trend of dividend increases is dropping off, indicating that corporations are becoming less optimistic about their future earnings.

* *

One of the most popular games among New York's wealthy set is seeing who pays what (meaning "how much") for apartments or condos or co-ops or buildings. The real news on this is carried weekly by the *New York Observer.* Recent hot news included Richard Perry (he runs a hedge fund) who bought Janet Annenberg Hooker's Sutton Place 17-room penthouse apartment for $10.6 million (Ms. Hooker died in December, '97 at the age of 97). Here's another: George Pietro (Vanna White's hubby) bought a townhouse at 36 East 67 Street for $9.75 million. He will move into his new home with his family, but Vanna says she'll remain in the Golden State. Guess they're not "getting along."

Another sign of the times is the yacht situation. A 100-footer is no longer an acceptable sign of wealth. Now the "in thing" is a custom built yacht well over 100 feet long. How are the boat-builders doing? They are booked up two and three years in advance. In fact, the yacht-makers haven't been this busy in years.

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What's happening in politics, or is anyone still listening? According to syndicated columnists Evans & Novak (and they are very good), Bush now leads Gore. They write, "Our latest count shows Bush now leading Gore 298 to 239" in Electoral College votes. They continue, "The internals of the *LA Times* survey shows Bush winning among key demographic groups, including independents and women. Bush even captures about 20% of Democrats."

* *

In impoverished regions of Canada, something new is happening. It's called DIAMONDS. In the Northwest Territory, under the frozen tundra, they are finding diamonds. Two billion dollars of investment are going into opening new diamond mines. DeBeers, the giant cartel which controls most of the world's diamonds, is engaged in a hostile bid to take over Winspear, a company that has large holdings in the diamond territory. The whole Canadian diamond area is considered the world's most exciting new diamond find.

The latest, however, is that DeBeers is giving up controling the world's supply of diamonds. Instead, DeBeers will concentrate on accelerating the world demand for diamonds. Get ready for a flood of ads all claiming that "diamonds are forever."

By the way, for your edification, REDS, R-E-D-S, is the way gems are scaled as to worth. R-- fine rubies are the rarest and most expensive stones. E -- emeralds are the second most expensive, particularly if they are high quality and come from Columbia. D-- diamonds are third. Small diamonds (under 1/2 carat) are not rare. Large diamonds

(above 5 carats, and certainly above 10 carats) are very rare and very expensive if they are of high quality. S-- sapphires are the least expensive, unless they come from Kashmir or Burma, and then, if the right color, they can be very expensive.

* *

In the year One, there were roughly 300 million people on the earth. The world population hardly budged for the next 1000 years. By most estimates, there were fewer people on the earth in 1400 than in 1250. What happened? The Black death wiped out one-third of Europe's population. When I was a kid there were about 2 billion people on the earth. Now there are more than 6 billion. What happened again? It isn't that people starting breeding like a bunch of rabbits. It's that they stopped dying like flies. The decline in disease deaths has been phenomenal. The advances in medicine have also been incredible. When will the exploding population begin to level off? Demographers believe the population will be about 9 billion by 2054, then start leveling off. The population will be 10 billion by 2183. But the next millennium (after 3000) will be when world population stabilizes, according to demographers. Demographers also say that that "overpopulation is one of the few global problems that we know how to solve." How will it be solved? Empowerment by women. And improved legal, educational and economic gains by women. I've long said that one of the most important changes in the world is the new empowerment of women, via the vote and now via communications. Women have been men's virtual "slaves" since the beginning of time. That's changing rapidly. When it changes, the world will change. Item: the women's vote will probably swing the coming US election. As the father of four daughters, I'm all for woman-power.

* *

Surfing the web? It's getting more difficult. At latest count there are two billion web pages, 84% of them based in the US. By early next year, the total is expected to increase to four billion. Right now, the number of web pages is about equal to all the volumes in the giant Library of Congress. Happy surfing.

* *

Corporate insiders have been selling stock in their own companies in huge amounts. Filings for restricted-stock sales reached a record $22.2 billion in February. That was understandable since the monster rise in the tech stocks had many insiders ready to cash in their stocks after record gains. But in June, after so many tech stocks had been flattened, it was disconcerting to see insiders filing to sell $12.5 billion of their own company's stock; this was up from May's filing of $10.6 billion. Evidently, insiders are not at all sure that there stocks are going to be hitting the previous highs again.

* *

Why the disparity between the yields on Treasury paper and the yields on muni bonds (muni bond yields, which are not taxable, have been selling very close to the yields on Treasury paper, which is subject to federal taxes)? A very sharp subscriber writes that foreign investors and IRA/401Ks would be buying government paper since they do not need tax exemptions. That could account for the money going into Treasury paper (moving the prices up and the yields down) while leaving the muni paper alone.

* *

When a potential new law comes up, I always ask, "How will it affect our guys and gals in Congress? A law abolishing the estate tax (they call it the "Death Tax") is gaining momentum. The Senate and to a lesser extent the House is dotted with millionaires. Obviously, abolishing the estate tax is something they would love. **Russell Opinion:** I think that eventually the estate tax will be pared down substantially or eliminated. Millionaires in the House and Senate want it, and there are a lot of millionaires in both houses. As far as I'm concerned, the estate tax is an outrage. You pay taxes on your income all your life. Why should the government tax you a second time after you die? The nerve of those money-hungry, tax-happy government-monsters.

The latest is that the estate tax has passed in Congress but that Clinton vows to veto the bill. Clinton will claim that eliminating the estate tax will only help a small sector of the richest rich. As usual, Clinton is playing to the crowd and to the voters. The fact is that the estate tax is immoral and an outrage.

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Live a little: The world lifespan rankings provided a surprise. The surprise was that the US came in 24th. The listings were developed by World Health Organization scientists who have come up with a new indicator -- Disability Adjusted Life Expectancy. The highest ranking of the top nations belongs to Japan where life expectancy is 74.5. Australia is second at 73.2. France is third at 73.1. Sweden at 73.0. Spain at 72.8. Italy at 72.7. Canada number 12 at 72.0. The US was 24 at 70.0.

* *

In their attempts to prove that everything's all right some analysts are rewriting history. One analyst now claims that the famous Dutch tulip craze which ended in disaster wasn't really that bad, and, in fact, the prices paid for tulip bulbs weren't as high as claimed.

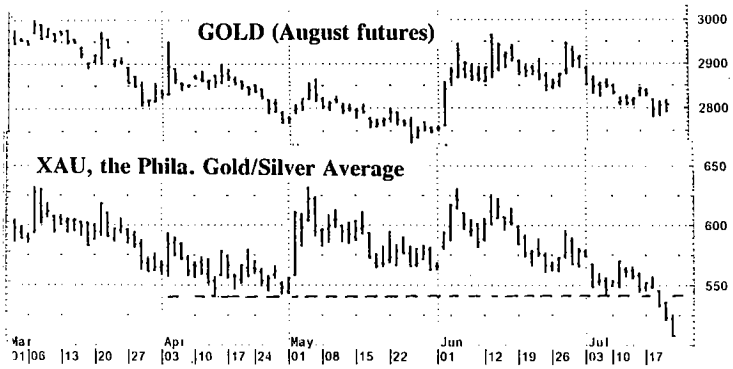
Then in an article in the June 12 *WSJ* I blinked as I saw a headline, "A Look at Roaring '20s Finds Optimistic Parallels." The article went on to say that the '20s were "great years for new stocks," and that "an earlier revolution in new technology has enduring results." The article continues, "The experience of the 1920s suggests the survivors will not only make up for the losers, but also will do so to an extraordinary extent, and that the Internet mania has served to mature some companies that could ultimately dominate the economy." In other words, the stock market collapse of 1929-32 wasn't that bad, because a lot of good stocks came out of the '20s. Well, I guess that's one way of looking at it.

GOLD: What's the worst we can say about gold? Well, the worst we can say about gold is that it's done nothing, this in the face of clear inflation in both the US money supply and in the price of what US consumers spend their money on.

OK, what's the best we can say about gold? Mmmm, let me see, how about this? As you can see on the chart, August gold hit a closing low of 273.40 on May 25. Last week XAU, the Phila. Gold/Silver Average broke to its lowest level since August of 1998 -- but the price of the metal didn't confirm.

That's the best you can say about gold? Yeah, as far as price action (which is what I trust most) that's the best. If I could say something more optimistic, believe me I would.

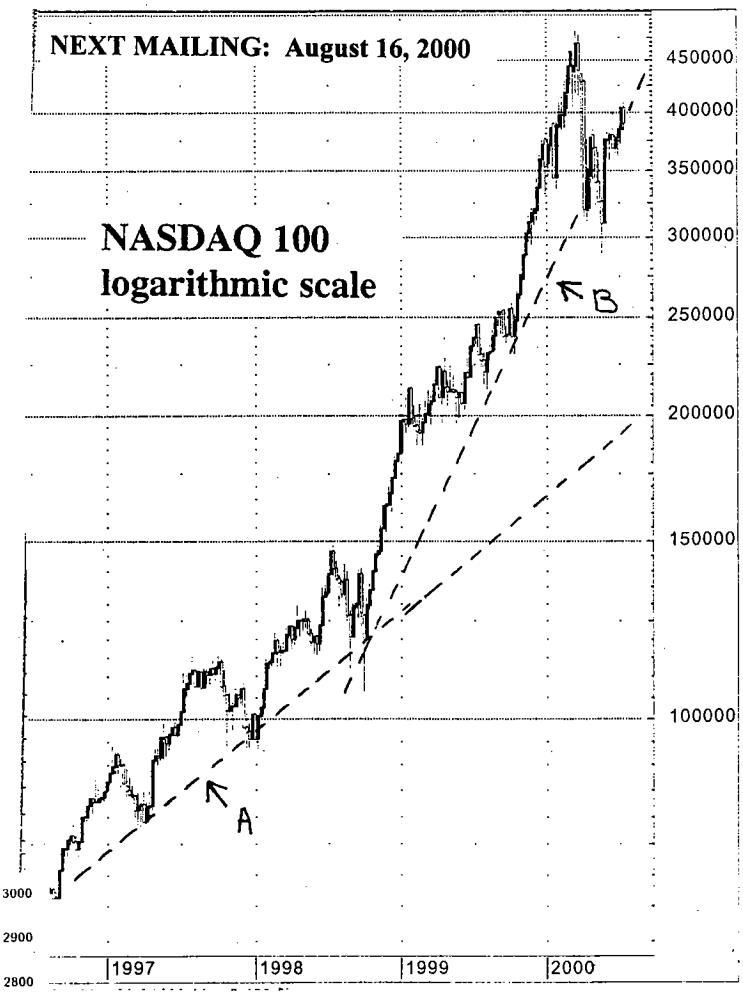
And of course, it could get worse. August gold could confirm the price action of XAU and break below 273.40. But let's not talk about that. What it does show, however, is that holding physical gold is holding real value, real money. Holding the shares is just not the same. Gold, the metal cannot go bankrupt, hasn't in 5,000 years. But gold shares can go bankrupt. You see, there is a difference.



NASDAQ 100: Problems. I show here (on the right) the Average that has been the "guts" of the tech mania. I'm talking about the Nasdaq 100, which includes the 100 biggest, "baddest," most powerful stocks in the very tech-oriented Nasdaq. This chart is set to logarithmic scale so that percentage of movements are shown. For instance, on this chart a rise of 500 to 1000 takes up the same vertical distance as a rise from 2500 to 5000 or a rise from 6000 to 12000.

What I want to show here is the rate of ascent. The rise through 1997 and 1998 was steep, and I doubt whether that rate of ascent could last too long. I marked that rate "A" on the chart.

But starting in October of 1998 the rate of ascent became far more acute. This trend is marked "B" on the chart. My friend, John Carder, notes that the "B" rate is roughly 86% a year. This rate is clearly not sustainable.



Suppose the Nasdaq 100 (which is now selling at 145 times earnings!) was to return to its previous steep rate of ascent -- which is described by trendline A. If that was to occur this year, the Nasdaq 100 would have to drop to around 2000 or less than HALF its current value.

Of course, one other thing could occur -- the Nasdaq 100 could move sideways for a few years -- until rising trendline B intersected with the price. I view the odds of that happening as very slim, indeed.

Conclusion: The Nasdaq 100 is "caught" in an unsustainable rate of ascent. Or to put it another way, the Nasdaq 100, even if it could hold to trendline B, is priced so high that it is years ahead of itself.

LATE NOTES: The primary trend of the market is down, but my PTI, after being bearish for a year, has finally turned bullish -- but the advance-decline ratio is actually looking toppy. The market acts chaotic, aimless, up one day, down the next, then up. Stocks moving every which way, jumping or swooning on every indication of a penny over or a penny under "analysts' estimates." Paul Montgomery of Legg Mason notes that stock yields, relative to bond yields, are at their most over-valued in history. All in all, a perfect market to lose money in.